Liquidity without Liquidation

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We examine whether tax-aware equity strategies can provide meaningful liquidity without full liquidation or material impairment of their investment objectives. We find that substantial capital can be withdrawn while preserving tracking error, leverage, and pre-tax information ratios. Tax-efficient withdrawal capacity is generally greater for long-short strategies than for direct indexing and increases with the strategy's tracking error and leverage. An optimized withdrawal process can adapt withdrawal amounts to the strategy's capacity to offset withdrawal-related realized gains with realized losses, given the strategy's age and the prevailing market environment. Partial withdrawals can provide substantial tax-efficient liquidity while preserving the economic characteristics of the remaining portfolio and, in some scenarios, its ability to continue realizing net capital losses. Liquidity without liquidation is therefore an important dimension of the flexibility of tax-aware long-short investing.

Source: https://www.aqr.com/Insights/Research/Working-Paper/Liquidity-without-Liquidation